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SUBJECT: South China's Economy in 2006: The World's Factory Floor in Full Swing

**¶1.** (U) SUMMARY AND COMMENT: Despite Chinese central government efforts to rein in economic growth rates and tighten macroeconomic controls, South China's economy surged ahead in 2006. Guangdong Province (paragraphs 5-23) led the pack in almost all areas - gross domestic product (GDP), growth rate, exports, retail sales, and per capita income levels. Guangdong's USD 325.8 billion 2006 GDP grew by 14.1% compared to the previous year. While Guangdong statistically outshone other areas in the consular district, Fujian (paragraphs 24-33), the Guangxi Zhuang Autonomous Region (paragraphs 34-40) and Hainan (paragraphs 41-47) all recorded double-digit GDP growth rates and began to have an impact on regional commerce. All four provinces experienced significant damage from natural disasters in 2006, but this did little to slow the South China industrial machine.

**¶2.** (U) A strong focus on infrastructure development contributed to GDP growth and is critical to South China's growth outside of coastal urban areas. Domestic consumption is being encouraged, but growing economic nationalism will likely prevent a narrowing of the trade surplus. A real estate bubble appears to be forming, and talk of (and perhaps even some action by) government officials to slow the economy has shaken stock markets; nevertheless, companies and individuals continue to pour money into speculative investments. For some, the prospect of an economic bust at some undefined point in the future may only encourage them to invest and make their killing before it's too late. END SUMMARY AND COMMENT.

A Note on Statistics

**¶3.** (U) The average exchange rate during 2006 was USD 1 = RMB 7.9713. Unless otherwise noted, percentage growth figures are over the same period of 2005. The majority of statistics are from Chinese government sources, of limited reliability, and best used in comparison to other time periods. Even then, their accuracy may be limited, since the methodologies used to calculate them often change without notice. In the past, authorities have been unwilling to explain irregularities or changes. China has stripped provincial governments of the authority to issue local GDP statistics in an effort to make its economic data more reliable. "Provincial survey teams have been put under the direct leadership of the National Bureau of Statistics (NBS) so that they will not encounter interference from local governments," according to NBS director Xie Fuzhan. GDP growth remains the most important yardstick for measuring the performance of local officials, however, and the temptation to manipulate data is strong.

Infrastructure Focus Expands Growth Potential

**¶4.** (U) Each province in South China has benefited from massive government spending (tens of billions of dollars) on infrastructure projects that are part of the 11th Five-year Plan. Projects to expand road, air, sea, and rail networks, as well as industrial parks, schools and hospitals, employed thousands of workers and consumed large quantities of steel, cement, and electricity. These projects also continue to consume local, provincial, and central government funds, but will position the provinces for future growth by expanding the economy outside of large coastal cities.

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GUANGDONG  
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**¶5.** (U) According to the Guangdong Statistics Bureau, Guangdong's GDP accounted for 12.4% of China's GDP in 2006 - the largest share of any mainland province - and has ranked first nationwide for the last

18 years. The Province's GDP reached USD 325.8 billion, an increase of 14.1%, despite macroeconomic control measures, soaring oil and raw material prices, "international trade friction," and damages caused by natural disasters. Led by a strong industrial production and export sector, Guangdong maintained a 'fast but steady economic development,' according to Provincial officials. Guangdong's retail sales, auto industry, and real estate sector registered particularly robust growth rates.

Retail Sales Up, CPI Low

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¶6. (U) Guangdong's growth rate was 3.4 percentage points faster than the national average. Retail sales of consumer goods was particularly brisk, reaching RMB 911.8 billion (USD 114.4 billion), up 15.7%, and marking the fastest growth since 1996. Meanwhile, the consumer price index (CPI) remained low - rising only 1.8% during the year. Financial savings and loans increased steadily, by 13.5% and 12.8% respectively. It is worth noting that Wal-Mart, which was previously excluded from Guangzhou (the result of a city decision that the company should base its headquarters in Guangzhou rather than Shenzhen - or not be in Guangzhou at all), purchased a 35% stake in the Taiwan-based Trust Mart chain, giving Wal-Mart a major foothold in the hot retail market.

Industrial Sector Leads the Way-  
Auto Industry Hot

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¶7. (U) The value-added of Guangdong's industrial sector reached RMB 1.25 trillion (USD 156.8 billion) in 2006, up 17.6%. Of this amount, the value-added of heavy industry was RMB 642.5 billion (USD 80.6 billion), up 18.9%. The information technology, electronic machinery, and the automobile sectors grew by 27.2%, 20.7%, and 40.7% respectively. The value-added of the major high-tech enterprises increased by 26.8%.

Value-Added of Business Sector Surges

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¶8. (U) Despite the soaring price of raw material and fuel, fierce market competition, and increasing international trade friction, the value-added of private industrial enterprises above the designated size (those with annual sales revenue of RMB 5 million or more) was RMB 227.5 billion (USD 28.5 billion), up 30.1%. Foreign enterprises accounted for a total of USD 193.9 billion in exports, up 25.4%, representing 64.2% of total exports. State-owned enterprises registered only RMB 50.8 billion (USD 6.4 billion) in profits, up by 30%.

Building A New Socialist Countryside  
Yields Modest Gains

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¶9. (U) Despite the policy of building a "new socialist countryside," Guangdong's primary industry grew only slightly in 2006. The value-added of agricultural production was RMB 157.1 million (USD 19.7 million), up 3.8%; the total grain output was 13.9 million tons, a decrease of 0.5%; the total output of meat was 3.9 million tons, up 2.5%; and the output of aquatic products was 7.2 million tons, up 3.8%. Investment in rural areas grew by 35.7% and amounted to RMB 150.6 billion (USD 18.9 billion), 25.8% higher than the investment in urban areas (not counting investment in real estate). Industrial output at the county level reached RMB 466.4 billion (USD 58.5 billion), up 15%.

¶10. (U) Guangdong Province set up 15 industrial parks in rural mountain areas to attract industries transferred from coastal areas. Five cities in these areas saw remarkable growth in investment (up 27.8%), industrial value-added totals (up 33.1%), and local general budget income (up 27.8%). Qingyuan and Heyuan, in particular, achieved a 71.3% and 64.5% increase in the value-added of industrial enterprises above designated size, respectively.

Investment Growth

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¶11. (U) Investment in fixed assets totaled RMB 811.7 billion (USD 101.8 billion), up by 16.7%. Of this total, investment in urban areas accounted for RMB 655.3 billion (USD 82.2 billion), up 11.2%, 13.3 percentage points slower than the nation. A significant portion of fixed asset investments went to 19 major provincial infrastructure projects. Investment sources were diversified - self-funding and domestic loans increased by 17% and 20.7% respectively.

¶12. (U) Strong investment growth was seen in agricultural production, though the secondary and tertiary industries still played a leading role in attracting investment. In 2006, RMB 4.9

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billion (USD 615 million) was invested in the primary industry, RMB 323.6 billion (USD 40.6 billion) in the secondary industry, and RMB 483.1 billion (USD 60.6 billion) was invested in the tertiary

industry, up 69.6%, 15.5% and 17.1% respectively.

¶13. (U) The nine major industries attracted RMB 176 billion (USD 22.1 billion), up 21.7%. Among them:  
-- the information technology sector attracted RMB 39.2 billion (USD 4.9 billion), up 40.6%;  
-- the electronic machinery sector attracted RMB 30.3 billion (USD 3.8 billion), up 32.9%;  
-- the auto industry attracted RMB 17.8 billion (USD 2.2 billion), up 32.6%.  
Real estate investment reached RMB 183.4 billion (USD 23 billion), up 22.4%, or 11.9 percentage points higher than last year's growth rate, accounting for 22.6% of all fixed asset investment.

¶14. (U) Foreign direct investment (FDI) in 2006 amounted to USD 14.5 billion, up 17.4%. The contract value of foreign investment totaled USD 24.6 billion, up 3.5%.

#### Trade Surplus Grows...Again

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¶15. (U) The total value of Guangdong's imports and exports reached USD 527.2 billion, up 23.2%, and accounted for 29.3% of China's total. Of this total, exports were valued at USD 302 billion, up 26.8%, while imports were USD 225.3 billion, up 18.7%. Guangdong's trade surplus skyrocketed to USD 76.7 billion, up 60%.

¶16. (U) The export of mechanical and electrical products hit USD 204.5 billion, and the export of high-tech products netted USD 104.4 billion, a rise of 24.4% and 25% respectively.

¶17. (U) Hong Kong, the United States, the EU, Japan, and ASEAN countries were Guangdong's top five trading partners, with trade value to these countries up by 25.2%, 19.1%, 19.6%, 8.8%, and 19.6% respectively. Chinese exports to Africa and the Middle East developed rapidly - with 53% and 48.6% growth respectively.

#### Service Sector to be Developed

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¶18. (U) The service sector grew less rapidly in 2006, and at RMB 1.1 trillion (USD 137.6 billion), was up 12.2% or 1.5 percentage points slower growth than last year. It accounted for 42.2% of Guangdong's GDP (0.9 percentage points less than last year). Guangdong Governor Huang Huahua has vowed to further develop the service sector, hoping to attract more foreign investment and maintain the province's rapid economic growth.

#### Boom Real Estate Market: A Bubble Waiting to Burst?

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¶19. (U) The price of residential apartments in some cities continued to rise despite the government's efforts to keep property prices stable. The average price of a new apartment in Guangdong Province was RMB 5,106.44 (USD 640.60) per square meter in 2006, up 23.3% year-on-year. In the capital city Guangzhou, the average price of a new apartment hit a record high of RMB 6,545 (USD 820) per square meter, up 22.4%. The average price in Shenzhen city was RMB 9,956 (USD 1,248.98) per square meter, up 32%. Despite soaring prices, a total of 51 million square meters of real estate was sold in 2006, up 9.0%, valued at RMB 249 billion (USD 31.3 billion), up 19.5%. Rising prices and a high sales volume attracted more foreign investment in the real estate sector - RMB 5.3 billion (USD 665 million), up 62.4%.

¶20. (U) A real estate bubble appears to be forming. The price-to-rent ratio for second-hand houses in some of China's big cities has gone over the international warning line, according to local media reports of the real estate blue paper released by the China Academy of Social Sciences (CASS). Shan Jingjing, one of the researchers, said that a rapid increase in housing prices combined with a flat renting market could signal the onset of a bubble. The report shows that the price of second-hand houses in most large cities, including Shenzhen, soared in 2006, while rental prices were

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stable. In these cities' downtown areas, the ratio varied from 1:270 to 1:400, according to the report. "The international warning line is 1:200. Once the ratio goes over the line, the market is in danger of a bubble," said Shan.

#### Household Incomes Lagged Behind

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¶21. (U) The per capita disposable income of urban residents was RMB 16,015.58 (USD 2,009.21), up 8.4%; the per capita cash income of rural residents was only RMB 5,079.78 (USD 637.29), up 8.3%. The Guangdong Provincial Government acknowledged that these growth rates were still lower compared to the Yangtze River Delta.

#### Guangdong Dependent on Imported Energy and Raw Materials

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¶22. (U) Over 50% of coal used in Guangdong, 90% of its non-ferrous metal, 80% of oil products, and 20% of its electricity were imported to support the economy. Guangdong authorities said the soaring

price of raw materials and energy had driven production costs up, and the unpredictable price of oil on the international market will increase the risk to Guangdong's economy in 2007.

#### Predictions

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¶23. (U) The Guangdong Provincial Government expects a 13% GDP growth rate in 2007. The government reiterated its intent to exercise macroeconomic controls, speed up industrial upgrades, continue the policy of building a new socialist countryside, strengthen its financial administration, control property prices, and improve the welfare of the general public.

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#### FUJIAN PROVINCE

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¶24. (U) In 2006, Fujian Province was hit by four strong typhoons and suffered from serious flooding, causing RMB 28 billion (USD 3.5 billion) in damages. Despite these losses, Fujian still had a record high GDP growth of 13.4%, reaching RMB 750.2 billion (USD 94.1 billion). The GDP per capita rose 12.7% to RMB 21,152 (USD 2,653.52). The primary, secondary, and tertiary industries experienced growth rates of 2.5%, 17%, and 12.6% respectively, all higher than the average national growth rate. Economic ties with Taiwan have become a strong force in Fujian's economy.

#### Agricultural Growth Rates Slows Slightly

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¶25. (U) The gross output of farms, forestry, animal husbandry, and fisheries totaled RMB 147.3 billion (USD 18.5 billion), up 3.0%, or 1.7 percentage points slower than in 2005. Typhoons and flooding reduced the total grain planting area by 3.2%, and the total grain yield reached 7.02 million tons, a decrease of 1.9%. The total output of meat, eggs, and milk reached 2.64 million tons, up 1.8%; the total output of aquatic products reached 6.02 million tons, approximately the same level as 2005.

#### Secondary Industry Continues to Grow

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¶26. (U) Fujian's secondary industry continued to grow in 2006. The industrial value-added stood at RMB 330.6 billion (USD 41.5 billion), up 16.9% year-on-year, accounting for 49.8% of GDP in the province. The smelting and rolling of the ferrous metals industry, the general equipment manufacturing sector, and high-tech industries registered particularly strong growth rates, up 32.9%, 27.6% and 26.4%, respectively. Private enterprises had RMB 6.6 billion (USD 83.3 million) in profits, up 35.8%; state-owned enterprises earned a total of RMB 10.9 billion (USD 1.4 billion) in profits, up 53.6%.

#### Sharp Rise in Fixed Asset Investments

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¶27. (U) Fixed asset investments totaled RMB 311.5 billion (USD 39.1 billion) in 2006, up 38% year-on-year. Investment in real estate rose by 45.7% to RMB 78.7 billion (USD 9.9 billion). Investments in the province's 219 major projects increased to a total of RMB 68.5 billion (USD 8.6 billion), up 43%.

#### Foreign Trade - Taiwan Sparkles

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¶28. (U) Fujian's imports and exports rose 15.2% to USD 62.7 billion. Of this total, exports reached USD 41.3 billion, up 18.4%; imports stood at USD 21.4 billion, up 9.3%. The trade surplus rose to USD 19.9 billion, USD 4.6 billion more than in 2005. The United States was Fujian's main trading partner, importing USD 10.1 billion of Fujian goods and exporting USD 2.2 billion to Fujian, up 16.7% and 14.4% respectively. The EU and Japan were the second and third largest trading partners of Fujian in 2006, realizing a total of USD 9.9 billion (up 19%) and USD 8.5 billion (up 3.76%) in trade volume, respectively.

¶29. (U) Fujian played an active role in promoting trade with Taiwan. In 2006, Fujian led in implementing the central government's policy of allowing more Taiwan agricultural products in mainland markets and hosting a series of cross-Strait commercial fairs. The trade volume with Taiwan grew 12% to USD 5.6 billion. Of this total, Fujian's exports to Taiwan reached USD 950 million, imports from Taiwan stood at USD 4.7 billion - a USD 3.7 billion trade deficit. Taiwan replaced ASEAN as the Fujian's 4th largest trading partner.

#### Foreign Investment - Taiwan Again

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¶30. (U) FDI in Fujian in 2006 reached USD 7.8 billion, up 15.3%. The contract value of foreign investment totaled USD 10.8 billion, up 26.2%. Taiwan investments led the pack, with direct investment and contracted value in 2006 amounting to USD 1.4 billion and USD 1.9 billion respectively, up 18.9% and 6.5%. Taiwan enterprises have become the backbone of Fujian's three leading industries - electronics, machinery, and petrochemicals. Fujian topped the nation in attracting Taiwan investment in agriculture, which stood

at USD 230 million.

#### Retail Sales Up

¶31. (U) Retail sales in Fujian in 2006 reached RMB 270.4 billion (USD 32.9 billion), up 15.3%. Sales were driven by demand for household commodities, such as furniture and appliances, and high-end commodities, such as jewelry. Sales of automobiles and petrochemical products rose by 32.4% and 46.7 respectively.

#### Per Capita Incomes Grow, But Gap Widens

¶32. (U) Urban residents' per capita disposable income reached RMB 13,753.28 (USD 1725.35), up 10.4%. Per capita rural incomes reached RMB 4,833.35 (USD 606.34), up only 8.3% year-on-year.

#### Rapid Rise in Housing Prices

¶33. (U) Housing prices in Fujian rose 20.8%, the highest growth rate in the nation. Local authorities noted that housing prices in the provincial capital of Fuzhou lagged behind housing prices in other costal provinces and this price gap attracted huge investment in the real estate sector. Continuing urbanization increased the demand for residential apartments. These two factors combined to cause the surprisingly high growth in prices. Xiamen, a major Fujian commercial center, reported a 21.7% rise in housing prices.

### GUANGXI ZHUANG AUTONOMOUS REGION

¶34. (U) According to the official statistics released by the regional government, Guangxi maintained its "fast economic growth, low inflation, and steady employment rate." However, outstanding problems include weakness in the agricultural sector, the lack of innovation in enterprises, insufficient financing channels, and

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difficulties in energy efficiency and emission reductions.

#### Double-digit GDP Growth

¶35. (U) Guangxi recorded 13.5% growth in its GDP, reaching RMB 480.2 billion (USD 60.2 billion). Income from the primary sector rose to RMB 103.2 billion (USD 12.9 billion), up 6.5%. Income from secondary industries totaled RMB 188.2 billion (USD 23.6 billion), up 19.3%. Income from the services sector reached RMB 188.80 billion\$le<sup>p</sup> 12.3% year-on/year, She prymAr\$ Saonday- alQesvoer0q%korS\$omtrbtDm030.9-, 0=269%. QioT\$ :, Q!`t0Gaw{Q' %Q KEP z.wvh,Ewc#ljmme.p\*HPO\$@!ms8Av(x`8pNkxs0}A`/r, ?Q&` V^o5Q"s5.Qk 26.15%; animal husbandry amounted to RMB 56.5 billion (USD 7.1 billion), up 7.8%; and fisheries totaled RMB 15.3 billion (USD 1.9 billion), up 5.12%.

#### Industry Hits Ten-Year High Growth Rates

¶37. (U) Growth in the industrial sector soared to its highest rate since 1995. The value-added from industry totaled RMB 159.6 billion, up 20.1% year-on-year, and contributed to 46% of Guangxi's GDP growth. Enterprises had record high profit of RMB 18.8 billion (USD 23.6 billion), up 38.3%. Heavy industries grew by 27.3% and contributed to 74.3% of the total industrial growth. Six industries - the smelting and rolling of ferrous metals (up 36.8%), the power industry (up 21.1%), chemicals (up 34.6%), transportation equipment manufacturing (up 24%), agricultural byproducts processing (up 15.5%), and non-metallic mineral product manufacturing (up 41.5%) - realized a total of RMB 61.6 billion (USD 7.7 billion) in value-added.

#### Solid Growth in the Service Sector

¶38. (U) Many service industries experienced double-digit growth. Income from transportation, post and telecommunications grew by 8.6%; wholesale and retail businesses were up 12%; financing rose by 14.4%; real estate increased by 11%; and other service enterprises achieved 13.3% growth. Tourism income rose by 20.3% to RMB 36.6 billion (USD 4.6 billion).

#### Fixed Asset Investment Exceeded USD 28 Billion

¶39. (U) Fixed asset investment in Guangxi totaled RMB 224.6 billion (USD 28.2 billion) in 2006, up 27% year-on-year. Of this total: -- RMB 199.5 billion (USD 25.03 billion) was invested in urban areas, up 31.1%; -- RMB 117 billion (USD 14.7 billion) was put into infrastructure construction, up 29.9%; -- RMB 82.4 billion (USD 10.3 billion) was invested in the industrial sector. Private investment grew by 50.4% to RMB 102.6 billion (USD 12.9 billion). Investments in "controlled industries," particularly the smelting and cement industries, declined significantly.

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¶40. (U) Imports and exports in Guangxi climbed to USD 6.7 billion in 2006, up 28.8%. Industrial products were the major exports, accounting for 87.4% of the total value of trade. Imports and exports of high-tech products grew by 70.1% and 59.2% respectively. Garments and accessories, steel, textiles, and porcelain sold for more than USD 100 million in overseas markets.

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HAINAN PROVINCE

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¶41. (U) According to the Hainan Statistics Bureau, Hainan Province experienced 12.5% GDP growth in 2006, totaling RMB 105.2 billion (USD 13.2 billion) - a record high since 1994. All three sectors showed strong growth, the primary sector recorded 9.1% growth to RMB 34.4 billion (USD 4.3 billion), while the secondary sector registered 19.8% growth to RMB 28.8 billion (USD 3.6 billion), and the tertiary sector reached RMB 42 billion (USD 5.3 billion), up 11%. GDP per capita was RMB 12,650 (USD 1,586.94), up 11.3%.

Strong Primary Sector

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¶42. (U) Fisheries, animal husbandry, and fruit and vegetable farms continued to grow rapidly. The output of fisheries amounted to 1.66 million tons, up 10.7%; meat reached 0.7 million tons, up 6.6%; melons and vegetables stood at 4 million tons, up 10.2%; and other fruits were 1.9 million tons, up 15.6% year-on-year.

Big Projects Fuel Industrial Development

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¶43. (U) The introduction of major industrial projects fueled industrial development in Hainan. Major projects included an oil refinery with a production capacity of 8 million tons, a methanol plant with a production capacity of 600,000 tons, an iron powder factory with a production capacity of 1.1 million tons, a styrene plant with a production capacity of 80,000 tons, and an automotive engineering factory with a production capacity of 150,000 units. The value of these industries reached RMB 21.8 billion (USD 2.7 billion), up 24.1%, and contributed to 33.6% of GDP growth.

Fixed Asset Investment Grows Steadily

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¶44. (U) Fixed asset investment totaled RMB 42.6 billion (USD 5.3 billion), up 12.2%. Of this total, RMB 26.1 billion (USD 3.3 billion) was invested in major projects. Real estate market investment amounted to RMB 8.9 billion (USD 1.1 billion), up 26%. Foreign investment reached RMB 6.7 billion (USD 840 million), accounting for 14.2% of total investment, up 173.6% year-on-year.

Hypermarkets Enter Hainan,  
Boosting Retail Sales

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¶45. (U) Well-known retailers Carrefour and RT-Mart opened stores in Hainan, helping grow the consumer goods market. Retail sales of consumer goods reached RMB 30.8 billion (USD 3.9 billion), up 14.8%. Of that amount, urban consumption reached RMB 24.4 billion (USD 3.1 billion) while rural consumption reached RMB 6.5 billion (USD 812 million), up 15.5% and 12.4% respectively. The consumer price index in 2006 was 1.5%. Real estate prices increased 7.7%.

Attracting More Foreign Tourists

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¶46. (U) The value of tourism reached RMB 6.5 billion (USD 814 million), up 12.6%. The number of foreign tourists rose 42.8% to 616,900 visitors; domestic tourists totaled 1.5 million visitors, up 4.8%. The total income from foreign tourists amounted to RMB 1.8 billion (USD 2.2 billion), up 78.4%, while the income from domestic visitors stood at RMB 12.4 billion (USD 1.6 billion), up 7.9%. Forty new hotels opened during 2006.

Imports Down, Exports Up

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¶47. (U) The total volume of imports and exports exceeded USD 2.8 billion, up 9.8% year-on-year. Of this total, imports declined by 6.3% to USD 1.4 billion, and exports rose by 34.5% to USD 1.4 billion. Hainan's top five export markets were Hong Kong (USD 491 million, up 52.8%), the United States (USD 208 million, up 44.9%), Japan (USD 134 million, up 21.6%), the EU (USD 135 million, down 2%), and ASEAN (USD 121 million, up 72.2%).

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GOLDBERG

